DURHAM

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CITY OF DURHAM | NORTH CAROLINA

Date: **November 22, 2011**

To: **Thomas J. Bonfield, City Manager**
Through: **Keith Chadwell, Deputy City Manager**
From: **Reginald J. Johnson, Interim Director**
Department of Community Development
Subject: **Rebuild Durham, Inc. Rental Project Restructuring**

Executive Summary

Rebuild Durham, Inc. (RDI) currently owns and manages 13 single-family homes which were purchased and rehabilitated between 2000 and 2007 with HUD Home Investment Partnership (HOME) loan funds from the City of Durham. In accordance with HOME regulations, the properties were to be occupied by and remain affordable to households with incomes at or below 60% of the area median, for a period of not less than 15 years. Under the HOME regulations, failure to comply with the occupancy requirement during the period of affordability triggers, as in this case, a HUD repayment which is based on the HOME funds invested prorated over the 15 year period.

Currently, five of the 13 properties owned by RDI are vacant and not suitable for occupancy. Deficiencies in some of the occupied properties have also been identified. Consequently, the City of Durham is required to repay HUD approximately $208,000.00 in non-federal funds.

Recommendation

The Department of Community Development recommends that City Council adopt the FY 2011-2012 General Capital Improvement Project Ordinance superseding Grant Project Ordinance #14139, and authorize the expenditure of approximately $208,000.000 in housing bond program income in the form of a reimbursement to the U.S. Department of Housing and Urban Development and authorize the City Manager to execute a contract with Rebuild Durham, Inc. to restructure its rental program.

Background

Under the HOME program, not less than 15% of the entitlement amount must be awarded to Community Housing Development Organizations (CHDOs). For a non-profit to receive a CHDO certification, it must demonstrate that at least one-third of its board composition is comprised of low-to-moderate income persons or persons who live in low-to-moderate income neighborhoods. On a national basis, the CHDO requirement has achieved mixed results. While some CHDOs have established successful track records, many others have failed to complete projects and/or to maintain viable operations. RDI was certified as a CHDO in Durham in the late 1990's.

The first loan to RDI in the amount of $460,000.00 to acquire and rehabilitate 12 single-family homes as affordable rental units, was approved by Council in August of 2000 . At that time, RDI's business plan was to complete the initial 12 properties within 24 months and to acquire and rehabilitate an additional 15 properties in the third year. By the end of the third year, only 8 units had been acquired and rehabilitated. In August 2003, the loan amount was increased to $810,000.00 in order to provide each property with a unique loan rather than using a revolving loan strategy. Only the original 13 properties would be funded with this additional loan. With this adjustment, a new completion date of August 2005 was set. During 2004 and 2005, four additional properties were acquired before RDI's Executive Director resigned. In the absence of paid staff, one of the RDI board members served in that capacity to keep the properties occupied and all records in compliance with HOME requirements.

When a new Executive Director was hired in May 2006, the City awarded RDI $20,000.00 in operating grant funds and subsequently, the completion date for the final unit was extended to April 2007. In March 2007, the Department of Community Development arranged for RDI to receive capacity building training at HUD's Greensboro office.

In April 2007, RDI was awarded a $24,000.00 operating grant and $138,000.00 in acquisition/rehabilitation funds in an effort to allow the organization to continue working towards its initial goal of 27 properties. In July 2007, the final unit under the original contract was completed.

While RDI drew down the operating grant awarded them in 2007, it did not expend any of the additional monies awarded them to acquire and rehabilitate properties. The completion date was extended initially to May 2008 and then to December 2008. During the term of the final extension, between May and December of 2008, the Executive Director that had been hired in 2007 was terminated and board members assumed responsibility for the day-to-day operations of the organization.

In December 2008, RDI became delinquent in the payment of its City loans and the organization was notified of the 60-day delinquency. During a required HOME rental monitoring, the HOME documenting files were found to be incomplete and code violations were found in some of the units.

Throughout the first half of 2009, Community Development's staff met with RDI's board members to review compliance requirements and provide technical assistance. While loan payments were brought current, issues with proper file documentation continued. Formal written notice of failure to comply with HOME requirements and the terms of the City's loan was issued in October 2009.

In December 2009, Community Development staff met with the entire board and recommended to RDI that it strongly consider divesting itself of its portfolio either by selling properties on the open market and paying off the first mortgages and the City's second mortgages, or by conveying them to another non-profit with significant property management experience. An alternative recommendation offered by the staff was for RDI to contract with a property manager, experienced in managing federally-funded rental units, to manage these properties. The decision of the board was to request proposals from property management firms, and RDI sent out an RFP.

In 2010, RDI reported that it had not been able to find a property management firm interested in its portfolio of properties and in November of 2010, RDI hired a part-time Executive Director. Community Development staff met with the Executive Director to provide technical assistance with regard to HOME compliance requirements.

When the required HOME rental monitoring was conducted in March 2011, five of the 13 properties were vacant and RDI indicated that it did not have the resources required to repair the units to make them suitable for occupancy. Subsequently, the Department scheduled a consultation with HUD to assess options for dealing with non-compliance. Based on a review of the records and an exterior inspection of the vacant units, it was apparent to HUD staff that the project failed to meet the affordability requirements for the period specified and the City should assess its options to remedy the non-compliance. Considering it was not feasible to rehabilitate the subject units, the other options included pursuing the substitution of comparable non-federally funded assisted units or withdrawing the HOME investment and paying back that portion of the investment for which the period of affordability was not met. The City does not have the applicable units to meet the substitution provision.

Issues and Analysis
Twelve of the 13 properties owned by RDI have first mortgages held by SunTrust. Only 110 Chestnut Street, which is located in the Southside project area, is not subject to a first mortgage.

This contract with RDI to restructure its rental program is necessary to extract all HOME requirements from RDI properties, as a cure for the non-compliance which currently exists. The contract involves the release of all restrictive covenants, the release of all deeds of trust and the forgiveness of all remaining loan balances. These actions will provide RDI with maximum flexibility in determining the future disposition of its portfolio. RDI may consider, for example, selling some of the properties to generate income which can be reinvested in other of its properties.

The contract also requires RDI to deed the 110 Chestnut Street property to another non-profit, acceptable to the City.

To assist RDI in sustaining itself until the restructuring has been completed, the Department will provide it with an $8,000.00 emergency operating grant from the housing bond program income.

Once the HOME funds are returned to HUD, the City will request a waiver from HUD which would allow the funds, repaid by the City to be restored to the City's HOME account. HUD officials in Greensboro have indicated that they would look favorably upon such a request.

Alternatives
HUD has been aware of RDI's struggles with compliance for the past several years and the City's efforts to provide assistance. The proposed payback to HUD and RDI's program restructuring are voluntary actions by the City with HUD's knowledge. Should these voluntary actions not be taken, HUD would ultimately issue a formal request for the payback of the HOME investment.

In terms of other courses of action, the Department of Community Development did consider providing funds to RDI to rehabilitate its portfolio. However, such an investment would be a short term fix to current physical deficiencies and would not address the longer terms issues of file compliance and the sustainability of an organization dependent on rental income from only 13 properties.

Financial Impact

Housing bond program income is available as the payback source. As noted previously, the City will request that the payback amount be returned to its HOME account.

SDBE Summary
Not applicable to this item.